Summary of Insurer Financial Results

Workers' Compensation Advisory Council
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Insurer Financial Results Agenda

- Calendar-Accident Year Combined Ratios from NCCI
  - Montana
  - 36 NCCI States
  - Study States
  - 2006 Oregon Rate Ranking
- Pre Tax Rate of Return from A. M. Best
  - Montana
  - Study States
- Observations and Conclusion

Calendar-Accident Year Combined Ratio

- Why is the Calendar-Accident Year Combined Ratio an important financial indicator?

- Because it measures the adequacy of premiums to cover both the benefit costs and operating expenses of the benefit system, **not** taking into account investment returns.

Derivation of the Calendar-Accident Year Combined Ratio

The Calendar-Accident Year Combined Ratio is the sum of accident year losses, the calendar year expenses and the calendar year dividends divided by premium:

(Losses + Expenses + Dividends) / Premium

Losses include medical and indemnity payments and reserves (case and IBNR) on claims with accident dates beginning January 1 and ending December 31 of that year. That is, the losses are developed to ultimate.

Expenses includes all loss adjustment (attorney fees), commission, brokerage, taxes, licenses, fees, general and other expenses in a calendar year.

Premium is the net earned premium paid by the insured in a calendar year after application of adjustments such as retrospective rating, schedule rating and premium discounts but prior to reinsurance.

Investment income is not considered in the combined ratio.

What does the Calendar-Accident Year Combined Ratio indicate?

- A ratio of less than 100% indicates that the premium collected was adequate to pay losses, expenses and dividends. Therefore, a profit was realized for the year.
- A ratio of 100% indicates that the premium collected was equal to the losses, expenses and dividends paid.
- A ratio of more than 100% indicates that the premium was NOT adequate to pay losses, expenses and dividends. Therefore, a loss was realized for the year.

  Investment income is not considered in the combined ratio.

Sample Calculation of a Calendar-Accident Year Combined Ratio less than 100%

Inputs

Premium	$100
Losses	$50
Expenses	$35
Dividends	$5

Formula Calculation

Combined Ratio = ($50 + $35 + $5)/$100 = 90%

Result

Underwriting Result is a 10% profit.

Therefore, the insurer paid out 10% less than it collected in premium thereby realizing a 10% profit on the policies it wrote.

Sample Calculation of a Calendar-Accident Year Combined Ratio greater than 100%

Inputs

Premium	$100
Losses	$70
Expenses	$35
Dividends	$5

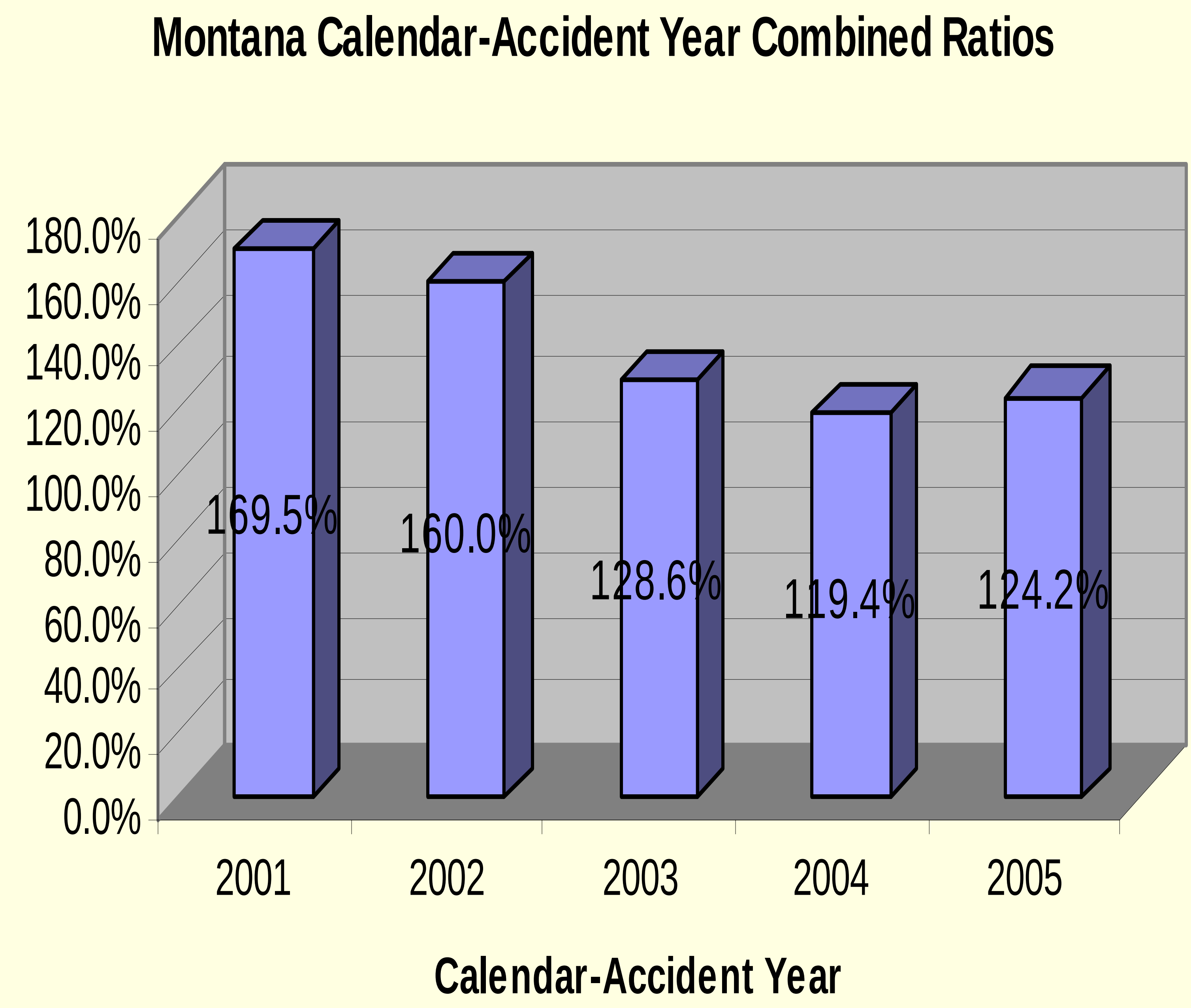
Formula Calculation

Combined Ratio = ($70 + $35 + $5)/$100 = 110%

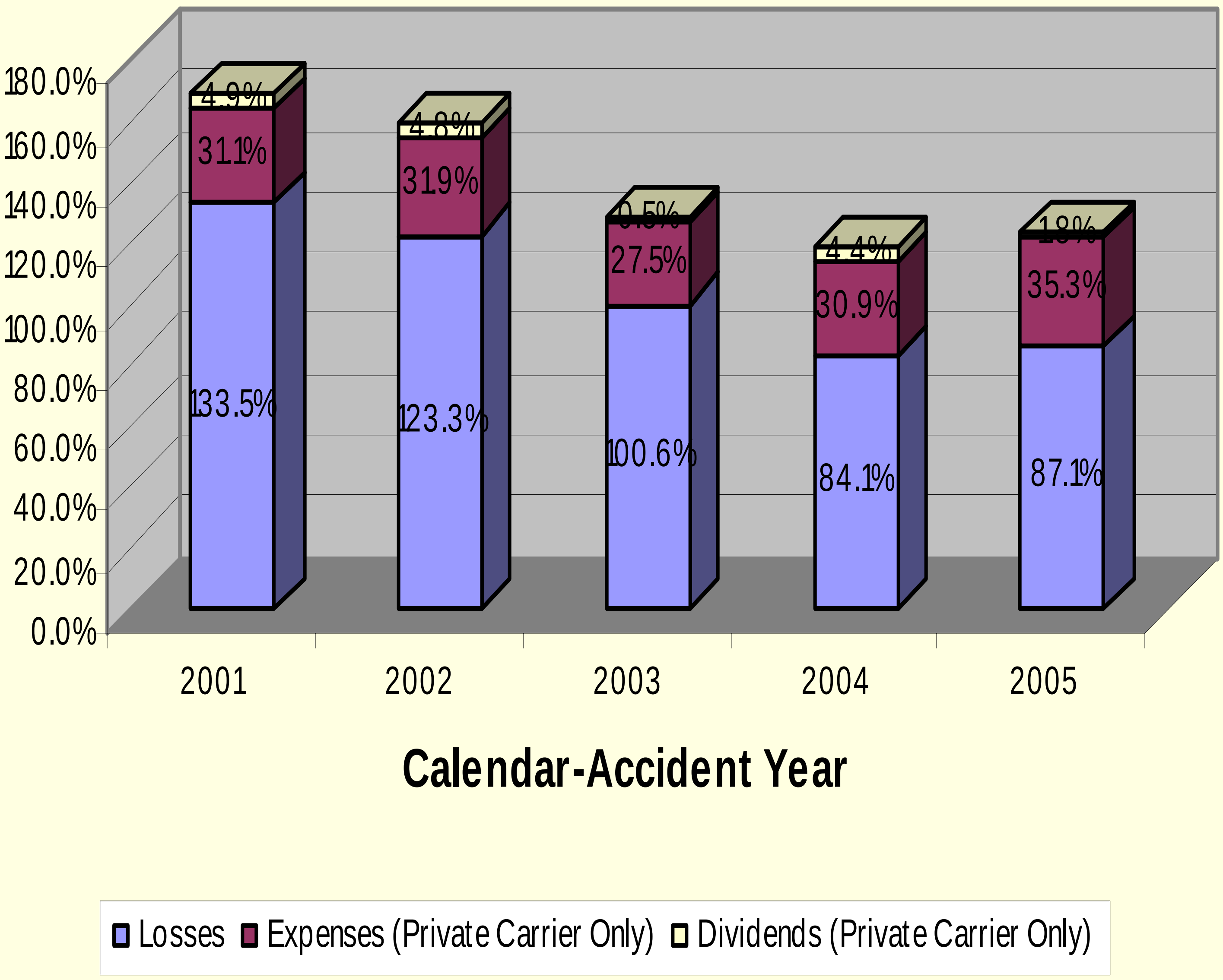
Result

Underwriting Result is a 10% loss.

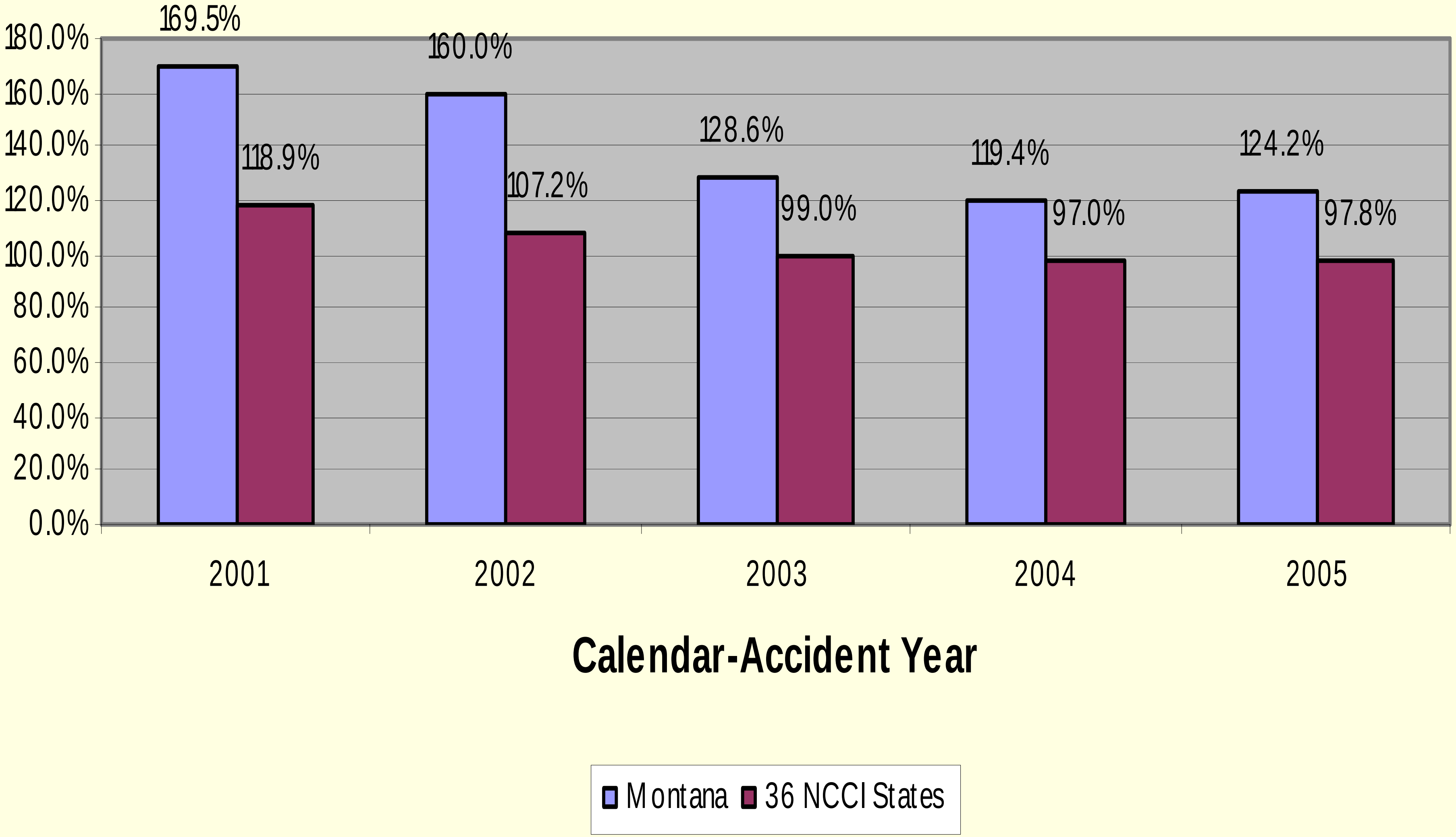
Therefore, the insurer paid out 10% more than it collected in premium thereby realizing a 10% loss on the policies it wrote.


Montana Calendar-Accident Year Combined Ratios
180.0%
160.0%
140.0%
120.0%
100.0%
80.0%
60.0%
40.0%
20.0%
0.0%
169.5%
160.0%
128.6%
119.4%
124.2%
2001
2002
2003
2004
2005
Calendar-Accident Year

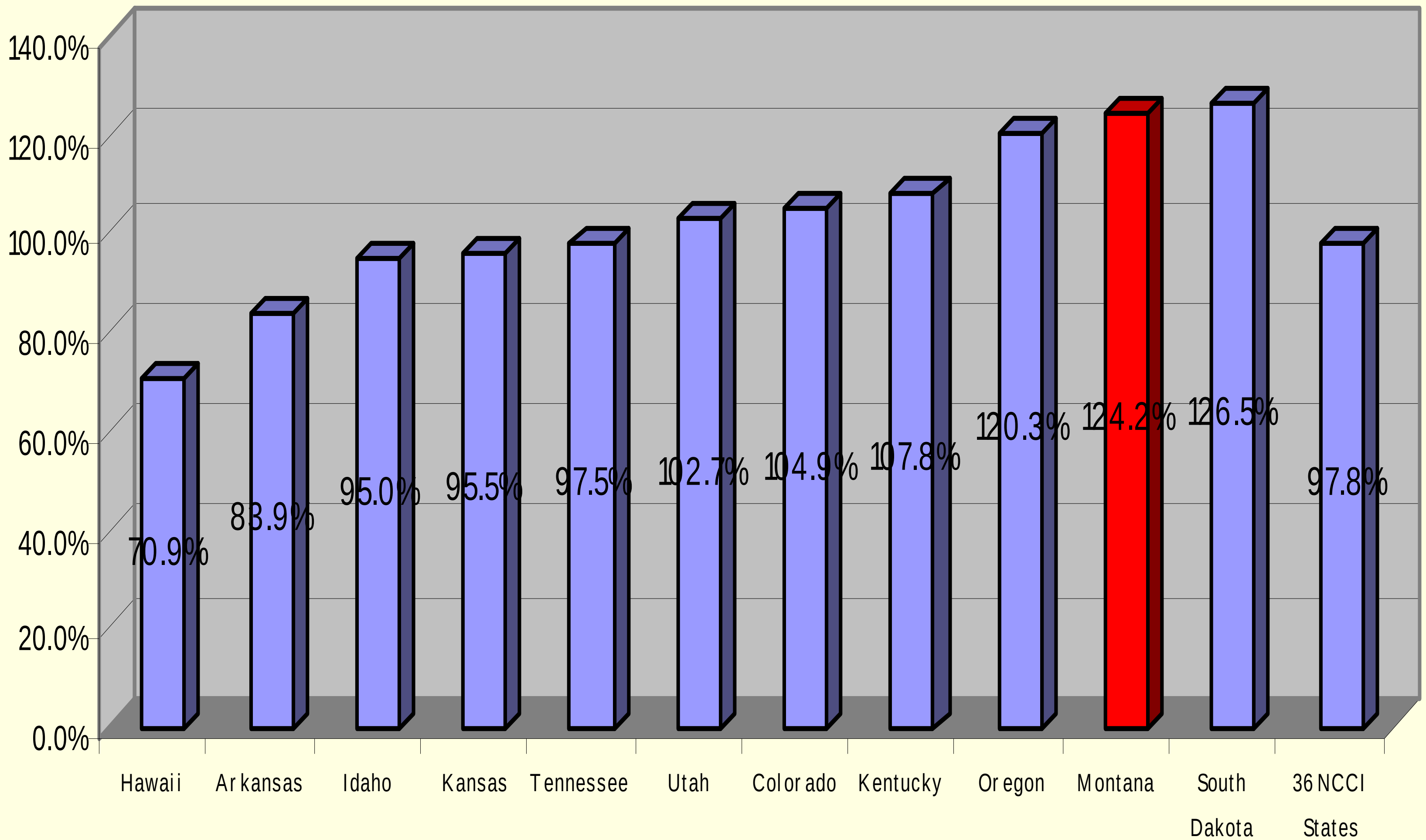
Montana Calendar-Accident Year Combined Ratios by Component



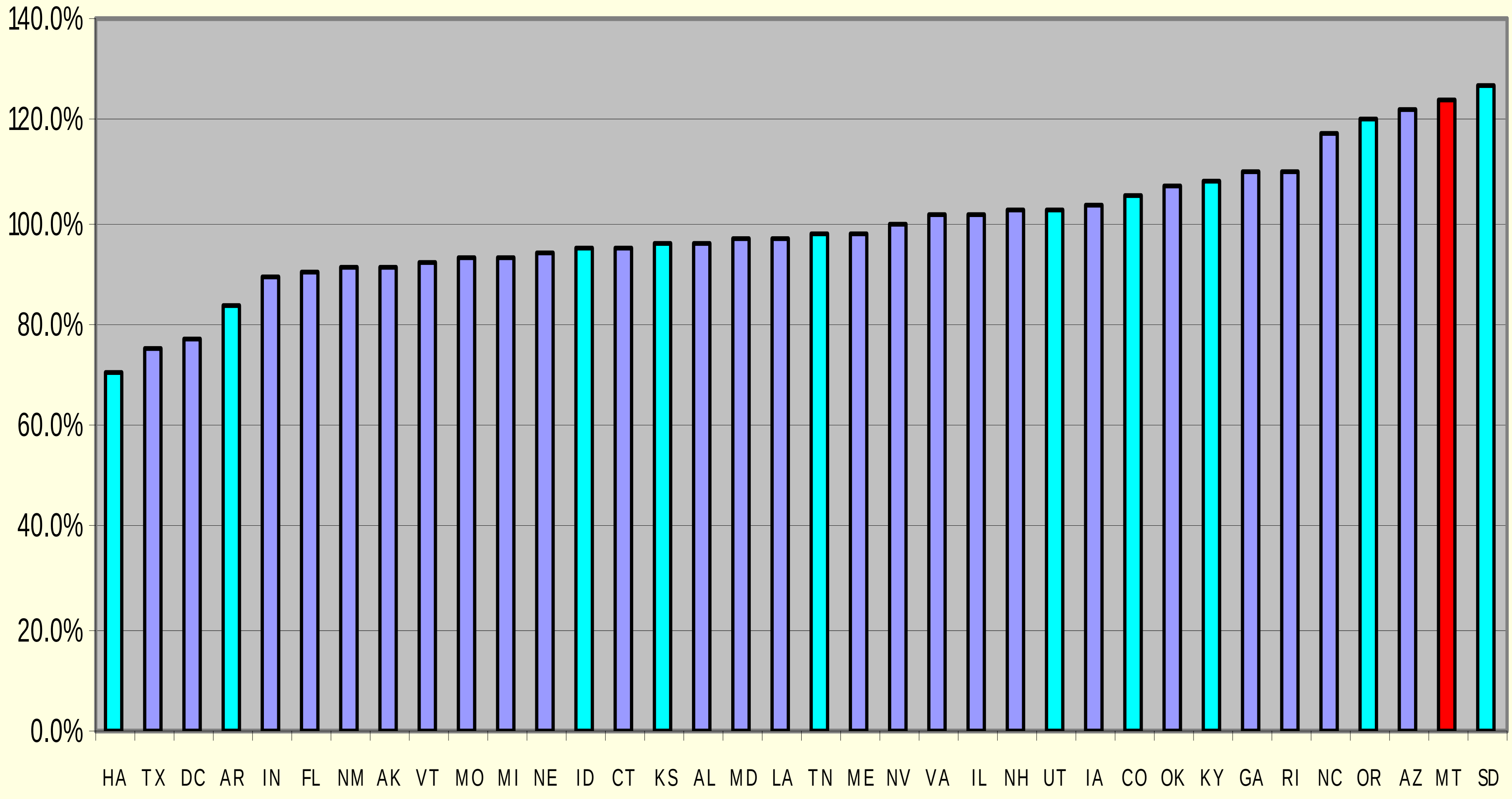
Montana versus 36 NCCI States Calendar-Accident Year Combined Ratios



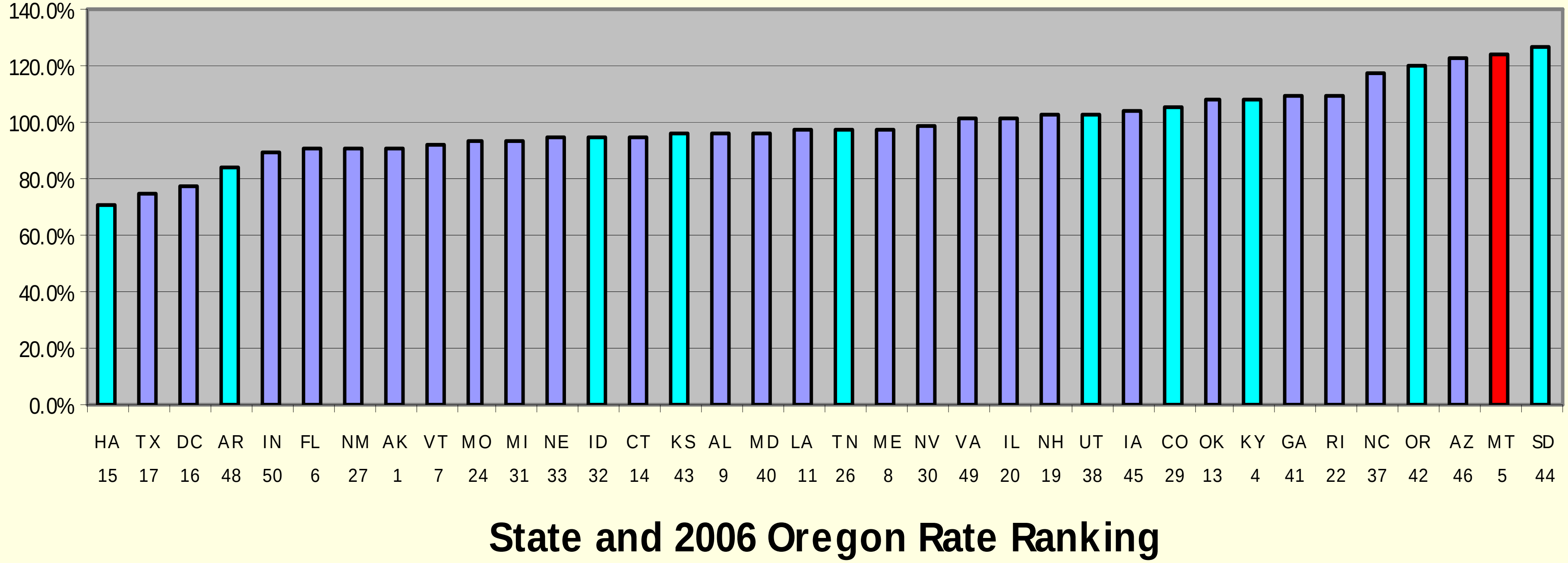
2005 Calendar-Accident Year Combined Ratio as of December 31, 2005 for the Study States



2005 Calendar-Accident Year Combined Ratios as of December 31, 2005 for 36 NCCI States



2005 Calendar-Accident Year Combined Ratio as of December 31, 2005 for 36 NCCI states and 2006 Oregon Rate Ranking



Pre Tax Rate of Return

- Why is the pre tax rate of return an important financial indicator to an insurer?

- Because it indicates whether or not the insurer is earning a profit or loss prior to taxes taking into account both underwriting and investment returns.

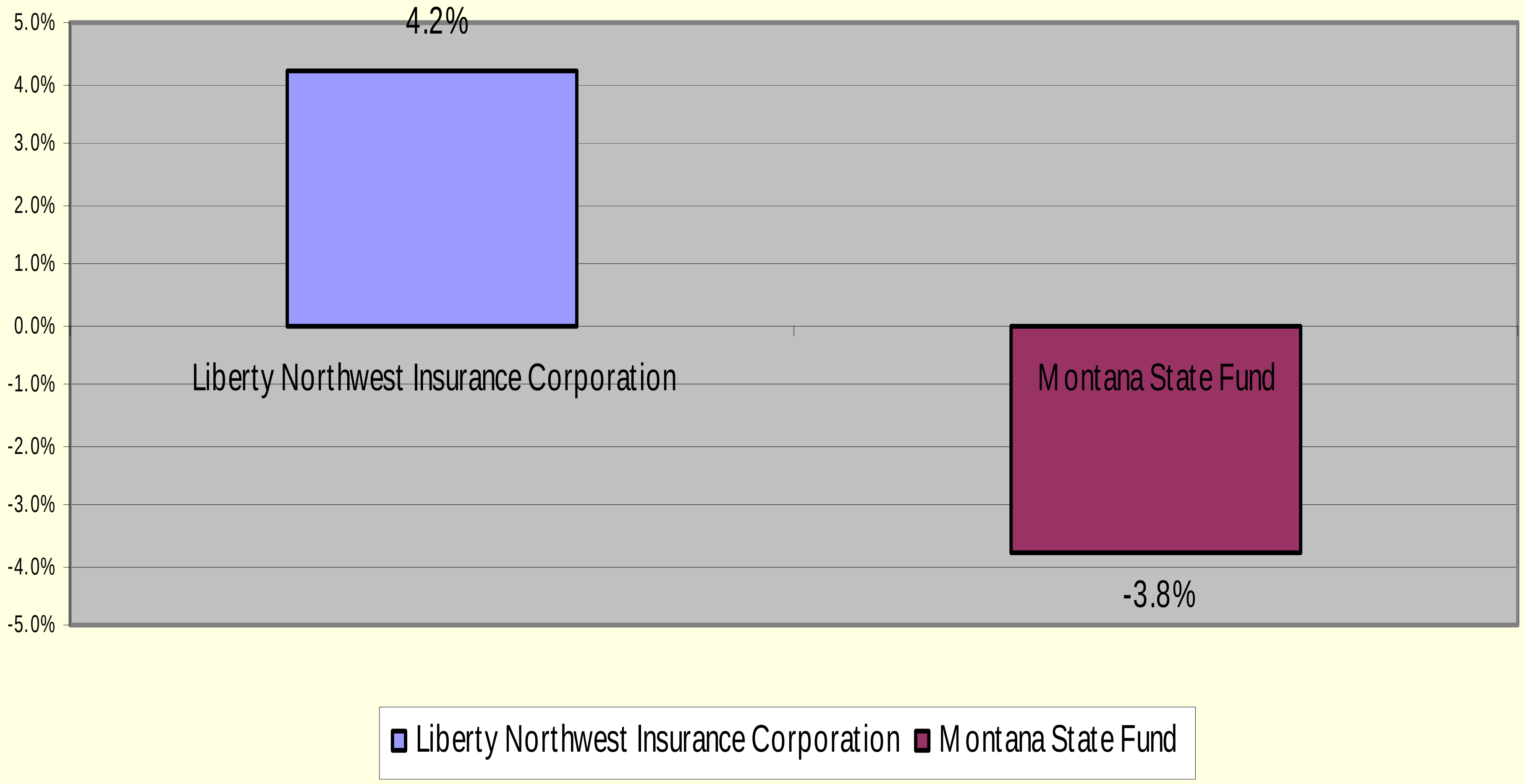
Derivation of the Pre Tax Rate of Return

The Pre Tax Rate of Return is the pre tax operating income or loss divided by net earned premium.

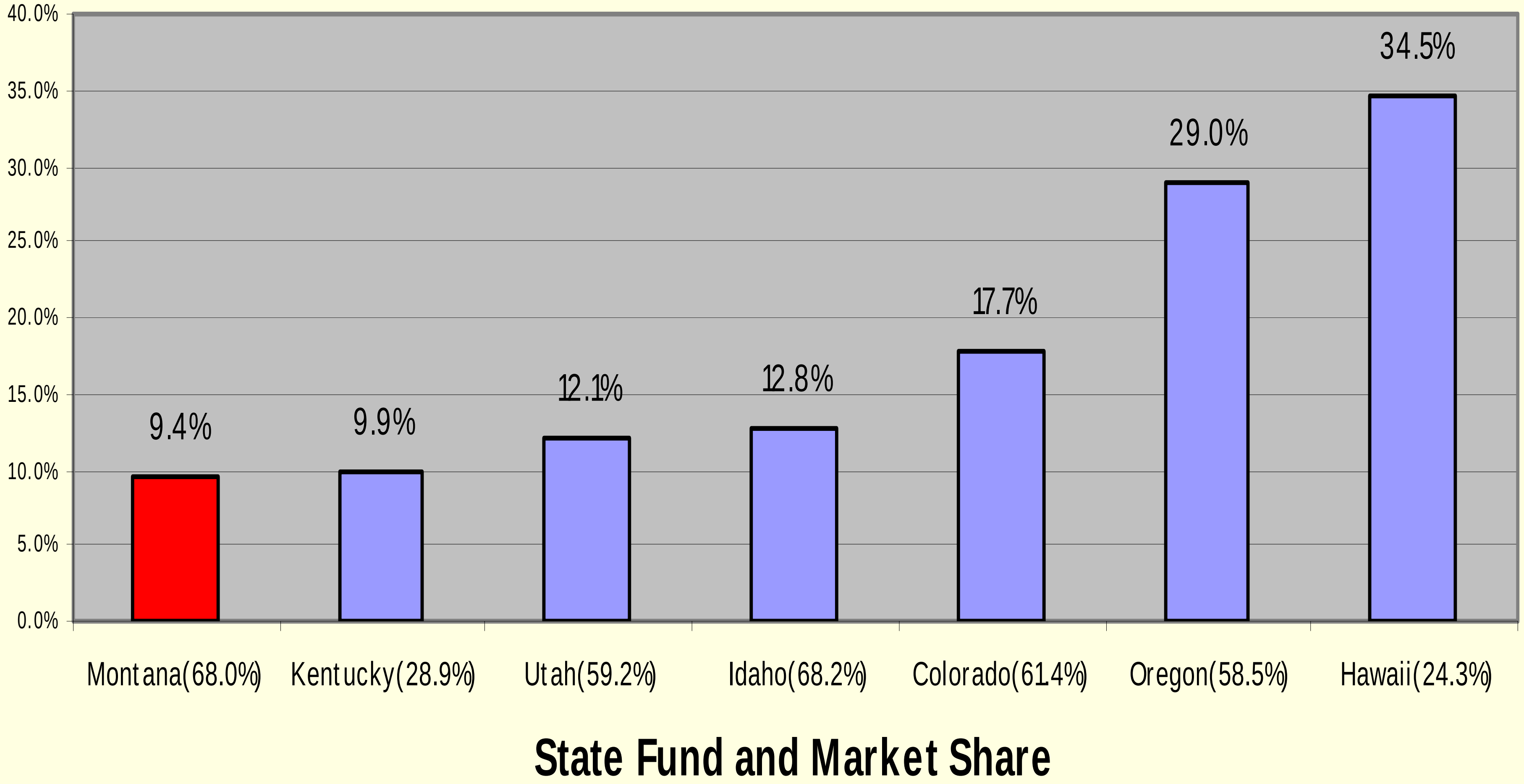
A positive pre tax rate of return indicates that a profit has been realized.

A negative pre tax rate of return indicates that a loss has been realized.

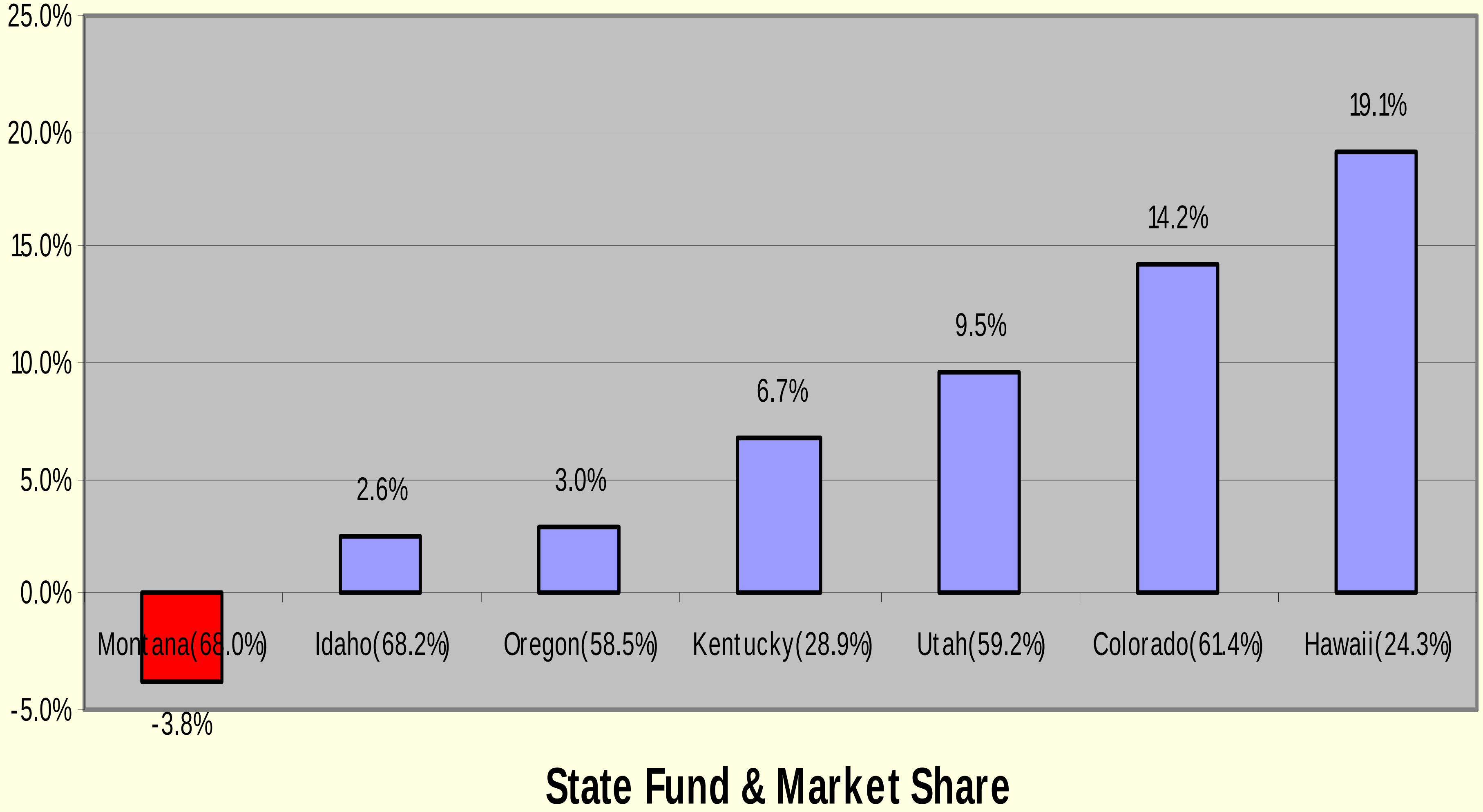
Five Year Average (2001-2005) Pre Tax Rate of Return from A. M. Best for Liberty Northwest Insurance Corporation and Montana State Fund



2005 Calendar Year Pre Tax Rate of Return from A. M. Best for the State Funds in the Study States



Five Calendar Year Average (2001-2005) Pre Tax Rate of Return from A. M. Best for the State Funds in the Study States



Observations and Conclusions

- While the experience over the last few years has improved, there is still much room for improvement.
- The frequency of workplace injuries has declined but medical costs continue to rise.
- The recently passed legislation is a good start but more work needs to be done. For example, increased workplace safety.